

Advisory Council on Intergovernmental Relations

Local Government Tax Policy: *Does Tax Policy drive Local Decision Making?*

Proceedings From the 2000 Annual Intergovernmental Summit (summary)
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West Coast Salt Lake Hotel

KEYNOTE ADDRESS

Rich McKeown, Chief of Staff to Governor Michael O. Leavitt & Formerly, Commissioner of the Utah State Tax Commission

Mr. McKeown gave the theoretical underpinnings and bases on which a tax policy should be constructed. He stated that our philosophies are identified with those who politically represent us. He gave the example of President Reagan who had the belief that the taxing power of government should not be used for regulation or social change but to provide the revenues for the legitimate purposes of state government. That was an underpinning of philosophy, but it became characterized in recognition that individuals and businesses make decisions based on self interest. Public organizations and governmental entities make decisions based on community interests. He added that public decisions affect private decisions. When changes are made in the tax laws, then different behaviors occur.

Mr. McKeown proposed some underpinnings of tax policy:

- 1—Reliability and Predictability
- 2—Broad Bases and Low Rates
- 3—A Tax Policy That Promotes Economic Development and Growth
- 4—Taxes Should Be Equitable and Fair
- 5—Tax Simplicity

There are those who suggest that our tax policy is nothing more than an *amorphous mass of competing self interest* and that whose ox will get gored is preeminent to any theoretical discussion. Mr. McKeown said that he didn't know if that had actually been fulfilled but he thinks that it could be a prophecy with some consequences. He demonstrated his point with license plates. In the early 1970's the license plate served two functions. The first function was to register the vehicle and to determine that the required fees had been paid. The second was to get an identifying number for purposes of law enforcement. Mr. McKeown said that the philosophy behind it is sound and the underpinning is the ability

to check. It was a simple process. Changes came about because the legislature decided license plates would make great billboards. Universities and others asked to use license plates for fund raising. We can now select between 41 different license plates. So now the purpose behind the license plate has changed. We have increased the complexity of administering government by obscuring that which was the original purpose of the license plate.

To deal with this the Tax Commission had to draft regulations. There are now 5 pages of regulations that deal with trying to implement that directive from the legislature. When someone asks for a particular name license plate the Tax Commission has to decide if it falls within the regulations. Someone asked for the name REDSKIN to be on his license plate because he was a Washington Redskin fan. It was granted. A lawsuit was filed because it was deemed derogatory and offensive. This patch work of law that relates to license plate law also relates as well to tax law. Tax law started out with some very simple policies and philosophies but they have evolved and changed. People have approached the legislature to change laws that would best benefit them and their businesses.

Mr. McKeown discussed the sales tax in Utah. It started in the 1930's. It was 2% of all transactions over the counter that dealt with the sale of tangible personal property. He said the sales tax has eroded over time. First, there has been an economic erosion because there has been a shift from the sales of tangible personal property to services such as dog grooming and massages. Much of our economy is not subject to sales tax so there has been a narrowing of the sales tax base. There have been legislative changes. From the 1930's to the 1960's the sales tax not did have any significant legislative changes. During the early 1960's the process of exemptions began. There are now 50 exemptions from the sales tax. Those exemptions increase the burden of compliance and increase the burden of administration.

The narrowing of the base of sales tax has created a detrimental situation. It is being propped up and masked by a very strong economy. Mr. McKeown said we have a system that is broken. We will either simplify it and broaden the base and lower the rates or the sales tax will fail. We need to work to simplify the sales tax. Presently there are 37 states that are involved in a simplification effort. They have been instructed by their governors to go with a blank page and find a way that works.

Mr. McKeown concluded by saying that we need to rethink what our tax policy ought to be and we all need to be involved in efforts to simplify each of these tax types. The simplification of taxes and the streamlining of regulations will be critical for the new economy.

CASE STUDY: DISCUSSION OF THE PROPOSED “GRAND MALL”

Michael Christensen, Executive Director of Utah Foundation, was the moderator for this discussion. He introduced Mr. Christensen Mayor Rocky Anderson, Mayor of Salt Lake City, and John Patterson, City Manager of West Valley City.

Mayor Rocky Anderson, Salt Lake City

Mayor Anderson said he appreciated being able to address the issue of the Grand Mall although it will not be coming to Salt Lake City. Other communities are looking at it with the prospects of bringing sales tax revenue. He said this points out to the need for regional planning and regional cooperation. We need to pull together as communities to discuss how we can promote our own interests as well as promoting interests of the entire region. Mayor Anderson's administration opposed the mall development for a number of reasons. First, it really was the definition of sprawl. Sprawl is the way that this nation's cities have gone for the past 40 years. The life and energy has been taken away from the city centers. He said that because of racist redlining following world war two—it was a governmental policy that has now been disclosed—it segregated us not only economically, but along racial lines. Sprawl has become the opposite of walkable, bicycle friendly, and pedestrian friendly neighborhoods. It is the opposite of core city revitalization.

Along Salt Lake City's main street corridor there is between a 35% - 40% retail vacancy rate. There is a lot that needs to be done to revitalize the downtown area. There is also the Gateway project which has been made possible by the investment of millions and millions of dollars of taxpayer funds. Mayor Anderson said we must make certain to do what we can to bring success to those areas. We need to bring good economic development to west side neighborhoods which have been neglected for many years. People living on the west side have complained that they do not have places to shop for the necessities. He said the answer is not a mega mall with eleven thousand parking stalls. The consultant that was hired by the Salt Lake City Council concluded that 90% of the revenues of this mall would come from other retail business along the metropolitan front. The city's major developers, the Downtown Alliance, Downtown Merchants Association, and the Best Pocket Business Coalition have all opposed this project.

Mayor Anderson said he feels the taxpayer should not be paying the kind of infrastructure demands that are being sought by the developers. The developers have already obtained a six million appropriation from the state legislature to build an overpass. They had sought fourteen million dollars in sales tax rebates from Salt Lake City.

Price Waterhouse Coopers recently came out with a publication called *Emerging Trends In Real Estate 2000*. They looked nationally at what makes for good investments and what the trends are. They concluded that the “mega malls” are failing and are a thing of the past. Mayor Anderson reiterated that he feels that the mall is the wrong way to go and we need to revitalize what we have now and build up our neighborhoods. He concluding by saying this is about a community's identity. Do we want a community that looks like every

other community or do we want to build up a communities identity and charm that attracts new people and visitors?

John Patterson, City Manager, West Valley City

John Patterson addressed the issues concerning the mega mall and the desire of West Valley to have it in their community. He said they have been looking into the mega mall concept for a number of years. They have a 400 acre site in West Valley City that is suited for this project. They looked at the impact this would have on transportation issues such as street congestion and the problems identified with the increase of automobile travel. They also asked if the issue of "sprawl" would be a concern in their community.

They looked at the incentives the developer was asking for. The total package they are asking for is 44.8 million dollars. Between 18 - 23 million dollars would come from the local jurisdiction where the facility is located. Mr. Patterson said they looked at the figures to see if there would be sufficient revenues coming in to justify this incentive. Mr. Patterson also quoted the report that was commissioned by the Salt Lake City Council and it indicated this type of "shoppertainment" is found in a mega mall and is a leading industry now in retail sales and development.

They looked at site issues and determined they wanted to make sure they had a site that had easy access. The initial study that was commissioned in April 1999 indicated that 33% of the shoppers would come from out of state. There are 22 million tourists that come to Utah annually and so they want to make sure that there is easy access to West Valley City.

They looked at the employment opportunities and what would be available. They looked at the issue of sprawl and the impact that it would have on their community. They asked, is this a trend or is it a wave of the future? Will it cannibalize the other existing businesses in their community and the Wasatch Front? They looked at the tax structure and developed some scenarios to determine if it was wise for their communities. They looked at the risk of financing the relocation of other businesses if needed. With the creation of 2500 jobs they concluded there were a number of other advantages to the mall and began to pursue it vigorously.

Mr. Patterson said the area they have looked at has an established RDA in place. In the past they have had the lack of funding incentives but this project gives them the opportunity to move forward. They looked beyond the 400 acres that the mall would consume and that area is ripe for development. There is a large customer base from the west side of Salt Lake County. The mall would be fourteen minutes from anywhere in the metro area and would have direct access from the interstate. Valley Fair Mall is the only mall west of I 215 and needs some assistance and the new mall would provide that help.

Mr. Patterson talked about the financial considerations. He said the first years sales are projected to be \$234,000,000. Of the \$14,000,000 generated in sales tax \$11,114,532 would go to the state with the rest of the monies going to Arts and Zoo, Local Option,

County Option and Mass Transit. Within ten years, sales are projected to be \$660,000,000.

Mr. Patterson said in the last few months there has been a lot of talk about sprawl. If they were to put the mall out by the tailing ponds that would be sprawl. Locating it in West Valley City on 400 acres, that is currently zoned for this use, is not the definition of sprawl. It is a continuation of their plan. With the development of the mall they see a beautiful gate way into their city.

Mr. Patterson concluded by saying that from a dollar and cents standpoint West Valley City certainly wants the mall. A few years ago they had a number of architects come and assist them in the overall development of their city and the mall would fit those plans. They continue to hear from businesses and citizens from West Valley City to move forward and make this happen and they are working to do just that.

QUESTIONS AND ANSWERS FOLLOWED THE PRESENTATIONS

THE STATE OF LOCAL TAX POLICY

Michael Christensen, Director of the Utah Foundation a private non-profit public policy research agency.

Mr. Christensen talked about trends of the three major taxes; sales, income and property tax, with the focus on the property tax. He said that half of the property tax goes to school districts but they are also an important part of local government structure.

Two years ago the Utah Foundation produced a report titled *The Property Tax Is It In Need of Reform?* It was written in response to the many property tax bills that come before the State Legislature. These bills address constituents complaints and what the media refers to as the most hated tax. At Utah Foundation they felt that sometimes the desire of the legislature to fix a particular problem was done so quickly that a more informed or broader view of the situation was not always taken. In other words sometimes we see the tree without seeing the whole forest first. Their report was written to help place the property tax in light of the whole forest. In writing the report they especially wanted to focus on two things; to place Utah's property tax in relation with the other taxes; and to provide an overview of the changes that have been made to the property tax over the last while. The book takes even a longer perspective of that because they go back to the beginning of property taxes.

In comparing the property tax with the other taxes Mr. Christensen showed a slide which compared the revenues from the three taxes. We raised \$1,805,000,000 from the sales tax, \$1,400,000,000 from the individual income tax, \$1,200,000,000 from the property tax, about \$300,000,000 from the motor fuel tax and \$192,000,000 off the corporate franchise tax. Over the last thirty three years there has been some annual average growth rate. The individual income tax has grown on an average annual rage of 12 percent. The sales tax

on an average annual rate of 11%. The corporate franchise tax 10%. The property tax 7.6% and motor fuel 8%. Total rate of growth of the five taxes is about the same rate as Utah's total personal income. Because of the slower growth of the property tax over this period of time a significant shift away from the property tax to sales and income has occurred. The trend in these taxes, not in revenue, but relative to personal income in otherwise they measured tax burden. The property tax has declined from 4.7% of our personal income to about 2.6%. A real drop in the property taxes, a burdensome tax on us as individuals. The sales tax has increased from approximately 2.4% to 3.7%. The income tax has doubled from 1.5% to 3%. The motor fuel tax has declined by almost half. The corporate franchise tax has been relatively unchanged.

If property taxes are so low and so less burdensome, relative to the other taxes in comparison to other states, then why do we keep trying to reduce this tax even further? Historically major criticisms of the property tax have been as follows:

It is claimed that property taxes are poorly associated with the cost of services owners receive.

It is argued that government can sell ones property for failure to pay taxes and therefore it is argued that one never really owns his home.

Property taxes are criticized because they are not directly related to ability to pay.

It is claimed that property taxes are hard to administer because of the difficulty and subjectivity of the appraisal process.

The argument that property taxes are poorly associated with the services rendered is true. The fact that property tax is not closely related to services rendered does not make it a bad or unfair tax.

Today we have a good property tax system in the way that it is assessed and the way it is collected. Since the Truth In Taxation our systems are more fair and more accurate. There is equity across county lines better than every before. It has accomplished it's major goal which is to slow the rate of increases. At the same time there have been some serious impacts of Truth In Taxation. The State of Utah actually executes one of the property taxes but does not collect it because it is considered a local government tax. That is the state mandated school levy. The way we finance education in Utah has a significant impact on property taxes.

Long ago the legislature realized that a school financed entirely off of property taxes was being unfair. For example, Park City School District's assessed value is \$1,100,000 per student. Tintic School District's assessed value is \$71,000 per student. Based on property tax Tintic School District cannot compete with Park City School District in funding educational systems. So the State of Utah decided that they would step in and provide some equity in the process. The state imposed the individual income tax and then in the late 40's they decided that they would use that as a source to equalize education across the State of Utah. Each year the legislature sets the amount of funding that it will provide for students in the State of Utah. It is based on the WPU (Weighted Pupil Unit). It is a

student count that adds up to one third more WPU. The state will then guarantee \$2,000 WPU and if a school district like Tintic can only come up with \$500 of the \$2,000 then the State of Utah will come up with the other \$1,500. Park City School District can come up with \$1,500 necessary and the state will put in the other \$500. The Basic School Program in the State of Utah is equalized for everyone.

The second thing that has happened with Truth In Taxation is that local governments have become more and more strapped. The result is that the sales tax has become the biggest source of revenue. What they forgot to tell the citizens when they passed Truth In Taxation is that local governments were also going to slow the growth in providing the services that citizens' demand.

Mr. Christensen said that in public finance a sound public tax policy has a few key principles. A tax structure is best when it is:

- Balanced
- Broad based with a minimum of exceptions
- Low rates that provide adequate revenue for public goods the taxpayers collectively want.
- A balanced tax structure is one that uses a wide variety of taxes and fees. This has several advantages. It allows taxes to touch consumption, income and wealth. It provides moderate rates for all of the taxes being used rather than high rates on just a few taxes.
- Taxes should treat individuals alike and business in a uniform and equal manner.
- Taxes should be as stable and dependable as possible. Frequent changes to taxes are disruptive to businesses and individuals. Businesses want one thing most of all in their tax structure. They want stability and dependability. They do not want to be surprised each year.
- Changes in tax policy should be carefully studied providing adequate time for input from affected entities. In recognition of this we have those systems in place. We have the Tax Review Commission, the Constitutional Revision Commission and both legislative bodies have their own interim committees. Taxes that are first introduced on the day of the session without going through interim review are ones that should be the most worrisome. There ought to be time for people to have input on how these tax changes affect people.

Mr. Christensen concluded by summarizing his key points.

- Property tax has long been criticized as a source for public revenue but yet it remains the most used tax in the entire United States as well as the world. Truth In Taxation is working well; it creates greater fairness and greater equity
- Second, slower growth in the property tax over the last 30 years has made it the least burdensome tax in Utah.
- Third, Utah's property taxes are some of the lowest in entire country.
- Fourth, sound public tax policy principles include the ones that have just been

mentioned. The balancing: broad based, minimum exceptions, and as low rates as we can possibly impose that will provide sufficient revenue to provide the public good that we as citizens of this state and within counties and our municipal process locally demand of our governments.

PANEL TOPIC: LOCAL REVENUE OPTIONS IN AN AGE OF SALES TAX UNCERTAINTY

Moderated by **Michael Christensen**

Mayor Tom Dolan, Sandy City/Board President of Utah League of Cities and Towns

Mayor Dolan's main points:

- There exists a decades long policy of the state legislature to decrease municipal dependence on property tax.
- Local governments have been able to decrease dependence on the property tax by increasing dependence upon other sources of revenue, mostly the sales tax.
- The state's dependence on the sales tax has actually decreased 5% while municipal dependence has increased approximately 15%.
- Sales tax is the most volatile piece of the tax pie.
- Nationally local governments report that they are approximately 24% dependent on sales tax. In Utah it is almost 10% higher.
- State leaders are fiscally conservative with municipal revenues by limiting, capping and outlawing sources they identify.

Mayor Dolan said his biggest concern in how we fund local government is not how we are funding it today. His biggest concern is what happens in the next recession. What happens in the next downturn of the local or national economy? How will we provide those basic services that we are required to provide: road maintenance, road building, police, fire and all of those services that are absolutely essential to the daily activities of our citizens?

Representative Ray Short, Chair, House Committee on Revenue and Taxation

Rep. Short's main points:

- If the legislature had not done anything about the property tax, property tax would have had six hundred to eight hundred million dollars coming in to the state.
- The counties get 21% from property taxes. A few years ago it was 25%. It has changed because the legislature allowed a 1/4 percent sales tax to the counties. As a trade off they had to drop the property taxes.
- If it were up to him he would get rid of property taxes, income taxes and have a 16 - 17% sales tax. By putting the income tax back into the mix, the sales tax would be

- about 11%, but he would still get rid of property taxes.
- If the legislature taxes services, primarily on lawyers, doctors and etc., they could drop the sales tax to 7% under Rep. Short's plan.
- Property taxes are too high.
- Until the legislature no longer earmarks income tax going to education they are still going to struggle to balance things out. In 1999 they collected more income tax than they did sales tax. Income tax is the tax that is going up.

Rep. Short discussed sales tax on food. He said that many people want sales tax taken off of food. If the legislature did do that the state would lose 140 million dollars a year. He thinks there are better things we could do for the poor. The legislature has a tough job to balance things but Rep. Short said they accept the challenge.

Natalie Gochmour, Deputy Director of the Governor's Office of Planning and Budget

Ms. Gochmour gave a personal example in Murray City, where she lives. Murray City has a fine standard for municipal services. They have their own school district, library system, power company and park system. The reason Murray is able to do that as a city is because they export all of their taxes. Fashion Place Mall is one of the largest retail establishments in the state and it is within Murray City. There are a lot of car dealerships along state street that also help fund the municipals services. So the citizens are not taxed for those services.

Ms. Gochmour reiterated what Mike Christensen said earlier. He said, changes in tax policy should be carefully studied and not happen frequently.

Ms. Gochmour talked about "what if's." She said people respond to incentives and her "what if's" are based on that premise.

1. "What if" is the point of sale distortion that it causes in the tax code.
2. "What if" property tax for water development.
3. "What if" the efficiencies that can come from more municipal, county and state coordination and cooperation.
4. "What if" Payments In Lieu of Taxes.
5. "What if"- the notion of flexibility.

Brent Gardner, Executive Director, Utah Association of Counties

Mr. Gardner said counties have a responsibility to provide critical public services and to

find the revenue to provide those public services. They have to do that in a very complicated political environment. Recently the Association of Counties had to face an incident to a critical service and in a complicated political environment. County government provides television transmission to 20 of the 29 counties in our state. In 1997 the federal government auctioned off television frequencies between the frequency of 59 and 60. Because the federal government auctioned off those frequencies as part of the budget balancing act in September of this year those frequencies (Channels 2, 4, 5, 7, 11, 13 and 14) will no longer be available for public television transmission. That has left counties, who are the licensee of those television transmission functions, scrambling to go to new frequencies. That necessitated revenue of about \$3, 500,000 state wide in order to that. This is an example of a complicated issue that local government gets faced with, with no prior warning and very little option as to where to go to get the revenue to do that.

Mr. Gardner's main points:

- County government is almost entirely dependent on property tax, where cities depend on sales tax.
- It has gone from 80% to 67%.
- Counties need diversified revenues to create a more balanced source for county government.
- Counties are recipients of a very small portion of the local option sales tax. In 1996 that amounted to about 10% of all of the local option sales tax that were generated state wide. That source of revenue in 2000 grew only two percent as a result of the additional 1/4 percent.

Mr. Gardner said that he is not sure what the solutions are to the problems that have been presented at the summit, they are real. Cities, counties and local governments do face an increasing demand for services. When they proposed the 1/4% sales tax they went through a year long joint task force with the legislature to try and come up with other alternatives to the property tax. If they can not rely on property tax they will have to go to sales tax or income tax. There are not a lot of options.

Mr. Gardner said he would welcome some kind of a comprehensive review of sources of revenue and allocations of revenue and to try and balance the system. County government, as a whole, has just entered into the sales tax arena and they would like to be a part of what ever is done to try and bring some certainty to that based on what the political environment is today.

Sen. John Valentine, Chair, Utah State Senate Committee on Revenue and Taxation

Sen. Valentine talked about the important concepts of what makes good tax policy:

- One of those is some kind of connection between the ability to pay and the ability to impose a tax.
- One that is becoming more and more important, especially in the business

community, is the ease of administration.

Sen. Valentine has been involved nationally on the Internet sales issues. They have been trying to convince Congress to not do the thing that they seem to be doing and that is extend and expand the moratorium on remote sales. Remote sales used to be a relatively small problem when Sen. Valentine first started in the legislature in the 1988. It was a relatively small problem because they were talking about the couple of hundred sales in the Sears and Penny catalogs. It was a small issue because those companies had contracts with the state and so they were able to try and work their way through it.

With the advent and expansion of e-commerce it becomes more and more difficult to try and retain the revenue streams that were formerly coming from transaction taxes, such as sales tax. Utah has had a growing economy but over the last couple of years the sales tax increase has been relatively flat. With a very large increase in the income tax it doesn't make sense that the sales tax should go flat in a growing economy, especially when there has been a population growth. Why? The only logical explanation is that someplace transactions that would other wise be taxable are not generating the sales tax. It is either non-compliance, it is coming from remote sales or people are not buying things in Utah. One of the factors has to be the explanation of why a sales tax would go flat when faced with a growing economy and population. It is difficult to project what the affect of the remote sales component is, especially the Internet portion. Tax policy decision makers are being faced with a very difficult political issue when people are saying "Don't tax me, Tax the guy behind the tree."

Sen. Valentine said there is one additional tax policy that has been lost in the debate on remote sales taxation, similar transactions should taxed similarly. Until that becomes part of a tax policy there will be problems in the transaction tax area, such as sales tax.

QUESTIONS AND ANSWERS FOLLOWED

LUNCHEON SPEAKER

Robert Kirby, Columnist for the Salt Lake Tribune (no summary prepared)